



**STATE OF WISCONSIN**  
**Department of Employee Trust Funds**  
**David A. Stella**  
SECRETARY

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**CORRESPONDENCE MEMORANDUM**

**DATE:** December 10, 2010

**TO:** Wisconsin Deferred Compensation Board Investment Committee  
Wisconsin Deferred Compensation Board

**FROM:** Shelly Schueller, Director  
Wisconsin Deferred Compensation Program

**SUBJECT:** Stable Value Fund Investment Advisory Agreement Correction

**Department staff recommends the Investment Committee approve a proposed correction to the *Stable Value Fund Investment Advisory Agreement* with Galliard Capital Management via a contract amendment.**

Galliard Capital Management (Galliard), a subsidiary of Wells Fargo Bank, has provided the Stable Value Fund (SVF) option for Wisconsin Deferred Compensation (WDC) Program participants since June 30, 1998. The WDC SVF invests in contracts issued by high-quality financial institutions which are backed by a portfolio of quality fixed income securities managed by Galliard and certain stable value collective funds held by Wells Fargo Bank and advised by Galliard, Pacific Investment Management Company, and Aberdeen Asset Management.

At the Board meeting in November 2009, Galliard provided an update regarding changes in the stable value market and proposed several changes to the existing WDC SVF investment guidelines. These changes included reducing the minimum weighting for cash equivalent/buffer fund allocation to five percent. This was intended to provide Galliard with some flexibility, as the intent was to gradually bring the cash equivalent/buffer fund allocation down to the ten percent range. The Board approved this change in November 2009. Unfortunately, we neglected to update the maximum allowed to the other component, managed synthetics. Per the current guidelines agreed to in November 2009, the maximum weighting to managed synthetics permitted is eighty-five percent. In order to make the math work, that number should have been adjusted to ninety-five percent to offset the change to the liquidity component to a five percent minimum (the two components should add to one hundred percent). The correction needed is shown below:

**A. SECTOR**

<u>Fund Level</u>	<u>Minimum Weighting</u>	<u>Maximum Weighting</u>
Cash Equivalents & Buffer Fund	5%	50%
Managed Synthetics	50%	85% ← should be <u>95%</u>

Reviewed and approved by Jean Gilding, DRS Division Administrator

Signature

Date

12/13/10

Board	Mtg Date	Item #
DCIC	12.15.10	2a
DC	12.15.10	1a

Galliard continues to believe the current optimum allocation is ten percent to the cash equivalents/buffer fund, with the remaining ninety percent to the managed synthetic component. The fund is being managed to this allocation, but because the managed synthetics allocation guideline was not increased to ninety-five percent Galliard has inadvertently exceeded the written guideline for managed synthetics. The proposed correction to the Investment Advisory Agreement between the Board and Galliard would bring the fund back into compliance.

Board approval of the proposed correction requires an amendment to the existing *Investment Advisory Agreement* between the Board and Galliard to formalize the updated guidelines. The Department has reviewed the correction and concurs with the proposed correction. A copy of the agreement, including the proposed correction, is attached to this memo for your review.

Galliard and Department staff will be available at the meeting to discuss this information with you.

Attachment: Third Amendment to the Investment Advisory Agreement

**~~SECOND~~ THIRD AMENDMENT TO THE INVESTMENT ADVISORY AGREEMENT**

This amendment (the "Amendment") is effective as of ~~December~~ November 25, 2009, 2010 by and between Galliard Capital Management, Inc. ("Advisor") and the State of Wisconsin through its Deferred Compensation Board ("Principal").

WHEREAS Advisor and Principal entered into an Investment Advisory Agreement (the "Agreement") effective June 30, 1998 and further amended November 8, 2001 and November 25, 2009;

WHEREAS, Advisor and Principal now wish to amend the Agreement;

NOW THEREFORE, the parties agree as follows:

**AMENDMENT**

1. Exhibit 1 of the Agreement is hereby deleted and replaced with the following new Exhibit 1:  
  
See Exhibit 1.
2. Except to the extent modified by this Amendment, the remaining provisions of the Agreement shall remain in full force and effect. In the event of a conflict between the provisions of the Agreement and those of this Amendment, the Amendment shall control.

**GALLIARD CAPITAL MANAGEMENT,  
INC.:**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
Date: \_\_\_\_\_

**STATE OF WISCONSIN DEFERRED  
COMPENSATION BOARD**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_  
Date: \_\_\_\_\_

November ~~2009~~ December 2010

**Exhibit 1**  
**Investment Objectives and Guidelines**

**State of Wisconsin Deferred Compensation Plan - Stable Value Fund**

**Investment Objectives:**

The primary objective of the portfolio is to provide safety of principal and a stable crediting rate, while generating a competitive return. The underlying fixed income portfolio on an aggregated basis shall conform to the following guidelines.

**A. SECTOR**

<u>Fund Level</u>	<u>Minimum Weighting</u>	<u>Maximum Weighting</u>
Cash Equivalents & Buffer Fund	5%	50%
Managed Synthetics*	50%	<u>985%</u>
<u>Underlying Asset Level</u>		
U.S. Government/Agency	0%	100%
Corporates	0%	50%
Asset Backed	0%	25%
Mortgage Backed	0%	65%
Non-U.S. Issuers (Yankee only)	0%	10%

No more than 5% of the aggregate portfolio will be invested in any one corporate issuer.

No more than 10% of aggregate portfolio will be invested in any other issuer other than the U.S. Government or its agencies.

No more than 20% of aggregate portfolio at time of purchase will be invested in corporate bonds within a single S & P industry code.

\*All managed portfolios must have book value wrap contracts in place.

**B. QUALITY**

Contract Level

The minimum quality of a wrap provider must be A-/A3 at the time of initial placement.

The minimum weighted average quality of the contracts will be maintained at A/A2.

Contract issuers must be on the Galliard "approved" list at the time of purchase.

**Underlying Asset Level**

**All securities will be rated investment grade at time of purchase.** The minimum weighted average quality of the underlying assets will be maintained at AA-/Aa3.

<u>Composite Long-Term Rating</u>	<u>Minimum Weighting</u>	<u>Maximum Weighting</u>
AA-/Aa3 or better	50%	100%
A-/A3 to A+/A1	0%	40%
BBB-/Baa3 to BBB+/Baa1	0%	20%

Minimum rating on money market instruments will be A1/P1 at time of purchase.

**C. DURATION**

**Targeted Effective Duration** – 3.0 years for overall portfolio. The overall portfolio shall be maintained within  $\pm 1$  year of the target duration.

**D. PERFORMANCE****Overall Fund:**

The long term portfolio goal is to provide a credited rate of interest to participants exceeding a similar duration U.S. Treasury Bond Yield (measured using the "Constant Maturity Treasury Bond" return calculation).

**Individual Managers:**

Individual manager performance is expected to exceed established benchmarks by at least .50% on a net of fees basis over a market cycle.

**E. PERMISSIBLE SECURITIES\***

1. U. S. Treasury notes, bonds, bills
2. U.S. Federal Agency Securities
3. Asset-backed securities
4. Corporate notes, bonds, and debentures, including domestic and foreign issuers (Yankee bonds), and securities issued under Rule 144A
5. Mortgage-backed securities
6. Mortgage pass through securities
7. Municipal securities
8. Forward purchase agreements
9. U.S. Treasury futures and Euro-dollar futures Agreements
10. Federal Funds
11. Repurchase Agreements
12. Money market instruments
13. Collective Funds investing in the above

\*All securities will be U.S. dollar denominated only.

## F. ADDITIONAL RISK MANAGEMENT GUIDELINES

### 1. Duration Stress Tests

- Entire portfolio must remain within .5 years of effective duration guidelines subject to  $\pm 300$  bp stress test of the portfolio.

### 2. Diversification

Exposure to any one single wrap provider shall be limited to not more than 35% of assets.

### 3. Credit Quality

- In the case of a split rating on securities, the higher rating shall apply.
- For securities downgraded below investment grade, or A1/P1 for short term securities, the manager shall be allowed up to 90 days to liquidate the security in an orderly fashion.
- For securities downgrade to BBB+/Baa1 or lower, to the extent the 20% maximum in BBB/Baa rated securities is exceeded, the manager shall be allowed up to 90 days to come back into compliance.

### 4. Portfolio Leverage and Derivatives

**The portfolio may not be leveraged.** Derivatives may be used to hedge portfolio or manage portfolio duration and cannot be used to leverage the portfolio in any manner or for speculative purposes. Any derivative products in the portfolio will be included in all measures of portfolio performance, including yield, duration, and convexity.

The portfolio may purchase securities for forward delivery as long as the position is fully incorporated in calculating the portfolio's duration.

The portfolio may purchase securities on a when-issued basis as long as the position is fully incorporated in calculating the portfolio's duration. Cash or cash equivalents must be held to meet forward commitments including mortgage rolls.

All structured notes which are issued by a non-governmental issuer must be rated A or better.

**Each manager shall adhere to the Galliard Capital Management Derivative Risk Management Policy which restricts/prohibits use of certain types of derivative securities and, in addition, the following security types will be prohibited:**

- 1. Caps, floors, options**
- 2. Mortgage backed derivatives - IO's; PO's; Inverse Floaters; Inverse IO's; Residuals; Cash Flow Floaters (kitchen sink bonds)**
- 3. Structured notes which have principal at risk in the payout method or have interest payments tied to a foreign currency, commodity, equity or equity index**